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SUBJECT: KERALA COMMUNISTS WORRY ABOUT COST OF SOCIAL PROGRAMS

¶1. (SBU) SUMMARY: The southern Indian state of Kerala has long been known for achieving a high level of social development despite poor economic growth and low incomes. Kerala's approach, known as the "Kerala model" of development, focuses on government spending on education and health care. Remittances from overseas Keralites have helped keep the system afloat. But Kerala officials are extremely pessimistic about the sustainability of the model, admitting that the "money is not there" to continue the government's costly health, education, and pension programs. END SUMMARY.

KERALA MODEL: HIGH ACHIEVEMENTS IN SOCIAL INDICES . . .

¶2. (U) Kerala regularly ranks highest among Indian states on various indices of human development, including literacy, average lifespan, and infant mortality. Life expectancy is 76 years (11 years higher than India's national average); literacy is 91 percent (26 percentage points higher than the rest of India). The state's achievements are credited to robust spending on social programs. According to media reports, it spends 36 percent more on education than the average Indian state and 46 percent more on health. This spending is sustained by the high level of remittances the state receives. Overseas Keralites send home 5 billion USD per year in remittances, augmenting the state's GDP by 25 percent. These remittances, though not taxed, lead to increased revenue through sales taxes paid on remittance-driven consumption.

. . . BUT GOVERNMENT SPENDING LEVELS UNSUSTAINABLE

¶3. (SBU) The amount of spending required to maintain the state's social programs is causing widespread anxiety. Politicians from the ruling Communist Party of India (Marxist) (CPI-M) and the opposition Congress Party, as well as bureaucrats and journalists we spoke with during a recent visit were unanimous in the view that the level of spending on health care, education, and pensions is unsustainable. According to government of Kerala figures, salary, pension, and interest payments consume more than 80% of the government's total revenue. Kerala, with an anticipated revenue deficit of 4.4 percent of the state's GDP in 2006-2007, has one of the highest budget deficits among all Indian states.

¶4. (SBU) In a recent meeting with visiting Consulate officers, Finance Minister Thomas Isaac described the state's dire financial situation. When we met, he glumly admitted the state was on the thirteenth day of a fourteen-day revolving line of credit. He kept a brave face saying it was largely "a liquidity question" and the Finance Ministry would need to shuffle some accounts to avoid overdrafting the line of credit. Isaac also said Kerala had reached out to the central government for support, requesting reimbursement for a 750 million USD shortfall in its budget due to decreased revenues from its postal deposit scheme. The shortfall, he explained, had resulted from the central Finance Ministry's decision to reduce interest rates paid on these accounts. Isaac obliquely

acknowledged that spending on social programs prevents the state from adequately addressing other critical needs when he advised against traveling to nearby Kottayam by road, saying that the state had not been able to adequately tackle road repairs. (NOTE: We observed that the roads in Kerala are in substantially worse shape than in the other south Indian states. Although the poor conditions could partially be explained by the fact that Kerala has already experienced the monsoon and the other states have not, the extremely poor conditions left no doubt that limited resources have also had an impact. END NOTE.)

15. (SBU) The state's bureaucrats were particularly gloomy. Chief Secretary Lizzie Jacob (the state's highest bureaucrat) told post

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"the money is not there" to continue the current levels of spending on health, education, and pension programs. Jacob explained that retirement at 55 years of age combines with the state's lengthy average lifespan (almost 74 years) to make pensions especially burdensome. According to Kerala's own figures, pensions account for 15.5 percent of the state's total expenditures; pension expenses increased 41.7 percent from 2005 to 2007. Health Secretary Dr. Viswas Mehta, whose Ministry employs the majority of the doctors in the state, agreed that the retirement age is a major burden. "All of our doctors take retirement at 55, when they are in their prime, and then go on to private practice," he said. Jacob also expressed frustration with the lack of continuity in government programs. She said each new government puts an immediate stop to projects initiated by its predecessor, resulting in enormous waste.

16. (SBU) In addition to fiscal constraints, there is growing competition from private sector education and health care providers.

Many people describe a two-tier system in place with anyone in Kerala who can afford to pay for private health care or education doing so, with only the lower classes utilizing public services. Executives from U.S. Technologies (a major U.S. information technology services company) mentioned that the wide array of private educational institutions in Cochin is a big draw for recruits with families. We observed numerous newly built high-end private hospitals as we traveled through south and central Kerala. In fact, Industries Secretary T. Balakrishnan told post that the proliferation of private medical facilities in Kerala is leading the state to emphasize medical tourism as an up-and-coming sector.

COMMUNISTS LOOK TO REVENUE FROM
PRIVATE INVESTMENT TO SAVE SOCIAL PROGRAMS

17. (SBU) Our contacts told us the political environment in Kerala means cutting social programs is a non-starter, despite the state's poor fiscal situation. Industries Secretary T. Balakrishnan said "the political will is not there" to cut spending. Chief Secretary Jacob agreed with this assessment. With spending considered untouchable, the politicians are focused on improving revenues. Education Minister M.A. Baby, who is also a member of the CPI-M's policy-making Central Committee, brushed aside the possibility of reducing spending. He told us higher revenues derived from increased investment, including foreign investment, are the answer to the state's problems. Baby said "we want investment." As if to insulate himself from questions about a Communist party seeking FDI, he added "Even Castro wants investment but your government's restrictions are holding it back." Another indicator of the degree to which the government is feeling the fiscal squeeze is that Baby suggested that the state might implement new user charges. In the past, user charges such as road tolls have been met with serious popular resistance in Kerala.

18. (SBU) Industries Secretary Balakrishnan and P.H. Kurian, Managing Director of the Kerala State Industrial Development Corporation said Kerala was eager for foreign investment, especially in the IT sector. The investment promotion efforts they described -- tax breaks, establishment of special economic zones, and bureaucratic facilitation -- are similar to those offered by the other south Indian states. But they admitted it was difficult to compete with their neighbors. Balakrishnan mentioned that the state was planning a trade promotion trip to the United States but, unlike the other south Indian states, the Chief Minister would not lead the

delegation. This, he said, sent the wrong message to prospective investors. The biggest problem Kerala has with prospective investors, according to Balakrishnan and Kurian, is land acquisition. Extreme sensitivity over land ownership by corporations means that typically companies lease space in government-established technology parks. Balakrishnan said companies prefer to locate in the other south Indian states because they are able to buy property there, which in India's hot real estate markets usually appreciates in value, rather than rent.

19. (SBU) COMMENT: Kerala's achievements on social indices are impressive. But the system is clearly under strain. Kerala's ruling Communists are looking to revenue from private investment to save the day. We did meet a number of business people who are happy to have set up operations in Kerala. But government officials and representatives of chambers of commerce were pessimistic about Kerala's chances of drawing substantial private investment when compared to neighboring economic powerhouses Karnataka, Tamil Nadu, and Andhra Pradesh. We agree that competition with the neighboring states, all of which have a more business-friendly reputation, will make it tough for Kerala to save its social programs on the back of revenues from increased investment. END COMMENT.

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